Verizon-Frontier Transaction
WC Docket No. 09-95

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FCC Mail Room

Ex Parte Presentation
Communications Workers of America
April 16, 2010

For the Communications Workers of America:
Vincent Trivelli and Randy Barber
NOTE: Contains Allegedly Highly Confidential information which is shown in red.

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What We Will Discuss Today

1. Updated Frontier financial information
2. Allegedly confidential Frontier financial projections
3. Update on State cases

Updated Frontier Financial Information

1. **March 24 Frontier 8-K discloses:**
   a. Deal financing – summary info only (nothing on terms, covenants & conditions other than estimated interest rate; nothing on maximum leverage ratios or minimum interest coverage; no indication of when / how interest rate moves)
   b. New $105 million payment to Verizon at closing for 3rd party intellectual property (first time this is disclosed)
   c. 2009 results for VSTO and Frontier and pro forma combined companies (while on their face the pro forma statements reveal serious deterioration, adjustments mask the full extent of differences between 2008 and 2009)
2. **April 6 Frontier 8-K contains presentation to investors (sale of notes)**
   a. Continues misleading use of pro forma data
   b. Other questions about "adjustments" (were they selectively used to achieve desired results?)

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What's New in These Disclosures?

1. Frontier deal and integration costs now estimated to be $333 million, up from $192 million at announcement (an increase of $141 million or 74%). Includes requirement that Frontier pay an additional $105 million to Verizon for 3rd party intellectual property (computer software); payment to be made at closing (do not know where Frontier will get the money)
2. 2009 pro forma results much worse than 2008
   a. Revenues down $423 million, or -6.5%
   b. Net income down $126 million, or -22.3%
   c. Access lines down -9.5%
   d. Frontier shareholder equity down $180 million, or 34.7%
3. 2009 actual results much worse than projected for 2009 in Frontier's highly confidential pro forma financial model
   a. Revenues [redacted] below model's projections ([redacted])
   b. Net income [redacted] below projections ([redacted])
   c. Free cash flow [redacted] under projections ([redacted])
4. 2010 projections – improbably – already [redacted] than 2009 actuals

2009 Actual vs. 2008 Actual

Combined VSTO and Frontier Pro Forma Results

2009 vs. 2008

Selected Financial Indicators (x 1,000, except per share)

	2009	2008	% Change
Revenues	$ 6,071,000	$ 6,494,000	-6.5%
Net Income	$ 439,000	$ 565,000	-22.3%
Net income per share	$ 0.44	$ 0.57	-22.8%
Access lines	6,355	7,020	-9.5%
Frontier shareholders' equity	$ 339,000	$ 519,045	-34.7%

Sources:

2009: Frontier 8-K, March 24, 2010

2008: Frontier Definitive Proxy Statement, Sept. 16, 2009

2009 Actual vs. 2009 Estimate

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2010 Estimate vs. 2009 Actual

Contains Allegedly Highly Confidential Information

Bottom Line

1. Combined company looks much worse now than it did when the application was first submitted.
2. Significant loss of access lines, revenues, and income
3. Question whether Frontier will be able to support debt repayment, capex requirements, and dividend promises
4. Financial model demonstrably unreliable, with 2010 projections already [redacted] than 2009 actuals even as Frontier and VSTO revenues, access lines, etc. continue to decline; even if Frontier's highly optimistic projections were defensible (which CWA believes they were not), they are now clearly *not credible*.

Frontier's Failed Business Model

1. Dividends are much greater than earnings. Since reinstituting them in 2004, Frontier has paid out almost $2.5 billion in dividends while earning less than half that ($1.1 billion), even before counting the $835 million Frontier has returned to shareholders via stock repurchased during that same period.
2. Frontier has almost exhausted retained earnings; would have to cut dividend by 60% or more within 2 years without Verizon deal.
3. Frontier's retained earnings declined 34% in 2009 alone – only $339 million remains out almost $2 billion in 2001.

Updated Financials

1. Combined net income down [redacted] million from the Frontier financial model estimate for 2009, and free cash flow is even worse, [redacted] million below projections from just 11 months ago.
2. In its rush to do this deal, Frontier didn't evaluate how the combined companies would perform under even modestly stressed conditions, as demonstrated by the financial model's dismal performance even before the deal is closed.
3. Frontier's projections are based on a far too rosy outlook that not only does not reflect reality, but seems designed to produce predetermined results.
4. Bottom line: The combined VSTO-Frontier entity is already [redacted] behind Frontier's over-optimistic projections less than a year after the deal was inked; it produced [redacted] million less in cash flow than expected and is facing at least $140 million more in integration costs than it originally anticipated.

Financial Model Has Serious Problems

1. It only provides for two scenarios for VSTO, $500 million in synergies and [redacted] – there is no facility to test alternative revenue OR expense assumptions; VSTO's revenues are projected to decline at an annual [redacted] rate even though it experienced a -6.6% to -7.8% revenue decline in 2009 (depending on pro forma adjustments compared) [VSTO = -6.6%; SpinCo = -7.8%]
2. There are three scenarios that can be invoked for "legacy" Frontier (the Base Case, the Wall Street Research Case, and the Alternative Case), but they produce a very narrow range of outcomes, for example varying from an average [redacted] in annual revenue declines, far below Frontier's -5.4% 2009 revenue decline.
3. The model has far too many hard-coded data points to make it analytically useful for testing alternative scenarios beyond the very limited ones that have been embedded.
4. Also, the process by which Frontier projected 2013 synergy savings is highly problematic. It is not a bottoms up analysis of VSTO operational needs. Rather, it simply applies Frontier's organizational metrics to the projected 2013 VSTO revenue levels and compares the resulting expenses to 2010 levels. [see public Frontier description of its synergies model reply to an IBEW Illinois data request, "SynergydocsPUBLIC.pdf," the public version of its confidential synergy overview provided document provided in reply to FCC 20]
5. Frontier's overaggressive synergy projections and unrealistically optimistic revenue projections combine to produce a highly distorted picture and does not provide any ability to analyze a realistic range of possible outcomes.

Frontier Under Stress

1. As mentioned above, Frontier's Financial Model only permits testing of a very narrow range of predetermined scenarios.
2. CWA consultant Randy Barber has made very limited changes to the model – on only one line of "live" data – to evaluate one moderately stressed condition (he is available to discuss and/or provide this adjusted Frontier financial model):
   a. Eliminating the projected $500 million in synergies, which is equivalent to the combined loss of revenues and/or increase in expenses of $500 million in 2013 and 2014 (utilizing the Base Case scenario for legacy Frontier).
   b. This represents less than 10% of projected revenues for the end point at the model's 2014 projection period ; put another way, it represents less than a 2% annual revenue miss from the model's projections for the combined companies.
   c. He tested one other scenario that eliminated synergies and applied the slightly less optimistic Wall Street Research Case, resulting in an additional [redacted] million in combined 2014 revenue/expense underperformance.
3. The elimination of $500 million in synergies (using the Base Case) results in a [redacted] decline in post-dividend cash flows ([redacted]) over the 2011-2014 period.
4. The elimination of $500 million in synergies using the Wall Street Research Case results in a [redacted] reduction in post-dividend cash flows [redacted] over that period.
5. Mr. Barber made no attempt to update the model for the fact that Frontier is already [redacted] behind the projections it produced less than a year ago. *CWA urges the Commission to require Frontier to update its financial projections to incorporate 2009 actuals.*
6. A real stress test would evaluate the potential impact of a range of reasonably conceivable combined revenue and expense variances from the Frontier model's basic projections. *CWA urges the Commission to explore the implications of a significant variance from Frontier's projections.*

Even Frontier's Own Financial Model Refutes the Company's Distorted Pro Forma Disclosures

1. In a recent investor presentation, filed with the SEC, Frontier argues that the combined company's free cash flow "is greater than any given year's scheduled amortization" of its debt, using a graphic that compares the purported 2009 pro forma free cash flow (before dividends) of $1.5 billion with annual debt maturities through 2024. [see Exhibit A]
   a. However, Frontier's financial model demonstrates that this argument is at best a significant mischaracterization. Even assuming that $500 million in synergies will be achieved, projected free cash flow only rises to [redacted] in 2013 and 2014, and is substantially less in earlier years (see the screen shot of Frontier's financial model on the next slide).
2. Another example of Verizon/Frontier's misuse of pro forma projections as an implicit (or even explicit) promise of future performance is Frontier's December 17 rebuttal of CWA's arguments [see the following slides]
3. It is important to bear in mind that the comparisons on this and the following two slides are based on a financial model that is already out of date and demonstrably over-optimistic, given the [redacted] million shortfall in cash flow during 2009 alone, along with the recently disclosed 74% increase in projected integration costs.

Concrete examples of how Verizon/Frontier make misleading claims

- Verizon/Frontier repeatedly bootstrap historic 2008 pro forma data to support assertions that are different than the projections in Frontier's own financial model
- Frontier financial model projections for revenues, expenses, cash flows, earnings, and other important financial measures are in fact very different in 2013 from what they were in 2008
- For example, see the Verizon/Frontier Ex Parte Letter to the Commission, dated Dec. 17, 2009:
  - "Free Cash Flow after dividend payments will be $681 million *without any synergies*, and $991 million if synergy targets are achieved" (page 4, *emphasis* added)
    - Frontier's own financial model (Base Case after removing synergies) reveals post-dividend free cash flows that are only [redacted] to [redacted] of what Verizon/Frontier tell the Commission they "will be" [redacted] million in 2011, [redacted] million in 2012, [redacted] million in 2013 and [redacted] million in 2014).
    - Even with the claimed $500 million in synergies, Frontier's financial model never gets within $300 million of the $991 million that Verizon/Frontier tell the Commission they will be [redacted] million in 2011, [redacted] million in 2012, [redacted] million in 2013 and [redacted] million in 2014). Below is a screen shot from the unadjusted Frontier financial model provided to the FCC, utilizing the $500 million synergies and Base Case assumptions (on the "PF" tab):

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Concrete examples of how Verizon/Frontier make misleading claims (continued)

- **Also from the Verizon/Frontier Ex Parte Letter to the Commission, dated Dec. 17, 2009:**
  - "Thus, analyzed properly, Frontier's leverage is actually quite comparable to Verizon, particularly the 2.2x ratio Frontier *expects to achieve* with synergies." (page 4, *emphasis* added)
    - Again, Frontier's own financial model refutes the Verizon/Frontier claim that Frontier "expects to achieve" a 2.2x leverage ratio . . . [redacted] The model projects post-synergy leverage ratios of [redacted] in 2011, [redacted] in 2012, [redacted] in 2013 and [redacted]n 2014.
    - It is worth noting that even these highly optimistic projected leverage ratios are quite unlikely to support the investment grade rating that Frontier says is its financial goal.
  - Verizon/Frontier make these same misleading assertions in their Opposition to Petitions to Deny (pages 20 and 22) and responses #16 and #17 to Commission's data requests
- **These are just two examples where Frontier's own financial model shows materially different numbers than those deployed by the Applicants to support their case.**
- **These problems are quite likely to be compounded over time, rendering the financial model even more inaccurate and irrelevant.**

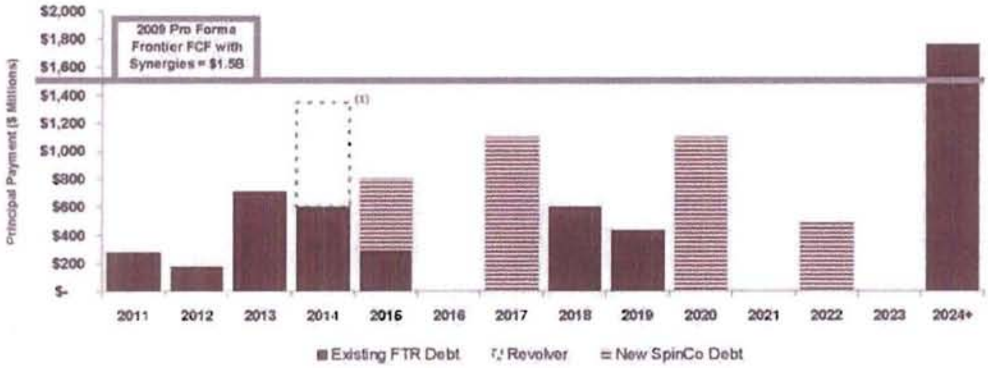
State Update

1. Illinois – Awaiting Commission decision. Commission is required to decide case by May 4; it has meetings scheduled on April 20, 21, 27 and May 4.
2. Washington – Awaiting Commission decision. Commission meets 2nd and 4th Thursday of month; next meeting is April 29.
3. West Virginia – Awaiting Commission decision.

Exhibit A.
Extract from Frontier Investor Presentation, April 6, 2010 SEC Form 8K

Manageable Debt Maturity Schedule

- **Balanced pro-forma maturity profile**
  - New issues were structured to align with the gaps in Frontier's existing debt maturity calendar.
  - 2009 Pro Forma Free Cash Flow (FCF) of $1.5 billion, with synergies, is greater than any given year's scheduled amortization



Notes
(1) The $750 million Revolving Credit Facility, that will become effective at the time of the merger, has a maturity of Jan 1, 2014.

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Additional Information from CWA

1. Several charts, partially developed for Randy Barber's confidential testimony in Ohio, Illinois and West Virginia, but now relying on highly confidential Frontier disclosures to the FCC. These charts illustrate the unprecedented nature of the proposed transaction and provide selected results from Mr. Barber's limited adjustment to the Frontier financial model.
2. A list of non-confidential citations to Hart-Scott-Rodino filings produced in various state regulatory proceedings.
3. A non-confidential comparison of the impact of the adjustments Frontier has made to its publicly disclosed 2009 and 2008 pro forma financial calculations.
4. A brief paper describing the Frontier financial model and the very limited adjustments Mr. Barber made to this model to test a "no synergies" scenario. This document contains confidential information. Mr. Barber is also available to discuss the Frontier financial model, the adjustments he made to produce a the no synergies scenario, and additional tests he believes Frontier should be required to perform. In addition, the adjusted version of the model can be provided to the Commission upon request.
5. A critique of the synergies spreadsheet and process Frontier used to develop it. This document contains confidential information.

NOTES ON FRONTIER'S SYNERGY PROJECTIONS

Randy Barber
Consultant
Communications Workers of America

CONTAINS ALLEGEDLY HIGHLY CONFIDENTIAL INFORMATION (IN RED TYPEFACE)

The process by which Frontier projected 2013 synergy savings is highly problematic. It is not a bottoms up analysis of VSTO operational needs. Rather, it simply applies Frontier's organizational metrics to the projected 2013 VSTO revenue levels and compares the resulting expenses to 2010 levels. As will be seen below, I have concluded that Frontier has significantly understated its projected expenses.

It is unprecedented to have expense savings of the magnitude projected by Frontier for a transaction of this size. Frontier projects that it will be able to cut VSTO's annual operating expenses by $500 million (21 percent of total VSTO expenses) by 2013. In order to achieve savings of this magnitude, Frontier will need to reduce the VSTO workforce and cut deeply into other costs. By comparison, when FairPoint purchased Verizon's access lines in Maine, New Hampshire, and Vermont, FairPoint projected reducing costs by 8 percent to 10 percent (and FairPoint has not been able to achieve even those savings). The most recent major merger involving rural landline operations, the CenturyTel-Embarq transaction, entailed projected synergy savings of 9 percent of Embarq's expenses. (See Table 1).

Table 1. Projected "Synergies" from Three Transactions

	FairPoint-Verizon	CenturyTel-Embarq	Frontier-Verizon
Projected "Synergy" Savings as a % of the Target's Operating Expense	8-10%	9%	21%

Sources: FairPoint SEC Form 8-K, January 16, 2007, 3rd page of press release; CenturyTel SEC Form 8-K, October 27, 2008, 2nd page of press release; Frontier SEC Form 8-K, May 13, 2009, p. 15.

Frontier's so-called synergy savings are either wishful thinking, or will require such draconian reductions in service, workforce, and maintenance that Frontier will not be able to deliver on its promises to improve service and broadband deployment.

[redacted][1]

[1] [redacted]

[redacted]

[redacted]

In a summary overview of the company's synergy projection process, which was provided publicly to the IBEW during the Illinois regulatory process, Frontier says:

> "Frontier was provided summary financial and operational information for the FYs 2006 – 2008, by Verizon, relating to Verizon's Wireline operations in 13 states (SpinCo, or the potential divestiture properties) (financial information for California was provided later, but is not material to the forecasts). Frontier identified the various components of the business (local, long distance, and data services) that would be acquired as part of the transaction and generated a historical and forward looking view of revenues and product units by state for the SpinCo properties.
>
> "Using this revenue and unit information, and the underlying metrics of demand activity that were available in the data room and via discussions with Verizon personnel, Frontier compared its stand-alone operating performance metrics to the projected view of SpinCo for the FY 2013

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[2] There is something of a discrepancy between the publicly announced synergies projection of 21 percent and the percentage reflected for the public "guidance" on this transaction. The difference is due to methodological variation.

and had our functional area teams develop a view of incremental headcount, wage expense . . . and non-wage expenses . . . necessary to operate the acquired properties at current Frontier stand-alone performance levels. . . .

"**Due to the nature of the data provided, synergy estimates by functional area and by state were unable to be created.** Additionally, the calculation of synergies used numerous estimates and assumptions which have yet to be validated by supporting documentation from Verizon. **No information regarding Verizon's "realignment" plan was provided prior to the determination of the anticipated value of the synergies.**" [3] [emphasis added]

[redacted]

In analyzing the credibility of Frontier's synergies projections, it is important to understand how these projections were created. Frontier received public financial data for 2006-2008 and validated this data through visits to a "data room" and conversations with Verizon personnel. However, in projecting VSTO's synergies under Frontier's management, the company took the 2008 VSTO cash operating expense data, projected it forward to 2010, using that as the starting point for its "final" synergies estimate for 2013. Describing confidential pages of the synergies overview document, Frontier responded to an IBEW interrogatory that

"[it] did not take any steps to convert the operating expense "summary buckets" into Departmental categories as reflected on the third and fourth pages of this document. Due to the nature of the data provided, synergy estimates by functional area and by state were not created. Rather, pages 3 and 4 were developed based upon Frontier's current organization and cost structure applied to the business to be acquired. The information received from Verizon was used only in total to create a starting point to determine amount of potential synergies."[4]

[redacted]

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[3] Frontier supplemental reply to Illinois IBEW 5.12(c), "SynergydocsPUBLIC.pdf" which is the public version of FCC Project North Expense Synergy Analysis overview HIGHLY c.pdf" in response to FCC 20.
[4] Frontier response to Oregon IBEW Data Request No. 249, August 25, 2009.

[5] " FCC Project North Synergy spreadsheet highly confidential 20.xls"

[redacted]

NOTES ON FRONTIER'S FINANCIAL MODEL[1]

Randy Barber
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CONTAINS ALLEGEDLY HIGHLY CONFIDENTIAL INFORMATION (IN RED TYPEFACE)

There are a number of ways to test the credibility of a firm's financial projections, one of which is to subject its model to something of a "forensic" analysis. This entails what could be described as an inside-out exploration of the entire model, to understand how it works, to judge whether or not its output is meaningful, and possibly to use it as a tool to test alternative scenarios (or sensitivities). In this case, Frontier's proforma model[2] yielded information about the assumptions the company has made, particularly with respect to the data it determined to insert into the program rather than subject it to further manipulation (of which there is much). I would describe the model's output as somewhat useful, but limited for the purposes of testing the credibility of Frontier's plans. It only permits two basic (very aggressive) scenarios for standalone VSTO and three fairly narrow scenarios for standalone Frontier. It combines the results of these limited standalone scenarios, but those results are not particularly useful in understanding the likely financial behavior of the firm under financial stress.

Fortunately, the question that I wanted to explore is quite straight forward: what risks can reasonably be deduced by examining the financial impact of plans gone seriously awry? From my initial analysis, it was clear to me that Frontier is banking on projections that have a fairly high risk of not coming to fruition. Significant underperformance on either the revenue or expense side can lead to similar pressures. In the end, it all gets down to available cash and the competition for access to it within a firm. While I can't predict with any precision how badly Frontier might undershoot its projections -- and I certainly don't know with any certainty how the company's leadership would respond in such a situation -- I can say with a high degree of certainty that it would do something. Management would obviously react and make changes. The question would be whether it still had sufficient resources available to it and what the magnitude of its financial distress might imply about the decisions it might take.

[redacted]

[1] As noted in the April 16, 2010 CWA ex parte presentation to the FCC, there are many reasons to question the on-going utility of this model. It clearly overstated 2009 results for the combined VSTO/Frontier operations and it does not include significant additional integration-related expenditures that have been disclosed. I continue to use it in this limited way because it is the only tool available to cast any possible light on the likely prospects for the combined companies. As mentioned on slide 11 of the April 16 presentation, the CWA urges the Commission to require Frontier to update its financial projections to incorporate actual 2009 results and to explore in depth the implications of significant variances from Frontier's clearly over-optimistic and outdated financial projections.

[2] " FrontierProforma Model highly confidential Feb 1 2010 2d lev.xls" provided by Frontier in response to FCC19.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

[redacted]

COMMENTARY ON 2009 VERSUS 2008 FRONTIER/VSTO PRO FORMA ADJUSTMENTS

Randy Barber
Consultant
Communications Workers of America

Synopsis: Frontier/VSTO pro forma financial statements reveal a seriously deteriorating situation for the combined companies . . . but the adjustments that Frontier makes in producing these calculations actually masks the magnitude of the declines.

Frontier/VSTO Pro Forma Results: 2009 vs 2008

	2008 Pro Forma Combined	2009 Pro Forma Combined	2009 Versus 2008	
Revenue	$6,494	$6,071	[redacted]	-6.5%
Cost and expenses (exclusive of depr & amort)	$3,400	$3,193	[redacted]	-6.1%
Depreciation and amortization	$1,574	$1,511	[redacted]	-4.0%
Total operating expenses	$4,974	$4,704	[redacted]	-5.4%
Operating income	$1,520	$1,367	[redacted]	-10.1%
Interest expense	$638	$648	$10	1.6%
Net income (loss)	$572	$439	[redacted]	-23.3%
Basic and diluted income per common share:	$0.57	$0.44	[redacted]	-22.8%

$Millions; Sources: Frontier Communications SEC Form 54, July 24, 2009, pp. 170-176; SEC Form 8K, March 24, 2010, pp. 5-11
Note: Data selected and condensed from original sources.

A key tool that Frontier has deployed in its arguments in favor of its proposed acquisition of the Verizon VSTO properties is the purported soundness of the companies' combined operations. Frontier has deployed the 2008 "pro forma" financial statements at every turn as the bulwark of this argument. Numerous regulatory interveners, including the CWA and IBEW, have severely critiqued Frontier's misleading use of 2008 numbers as indicative of 2013 or later results.

Now, Frontier has for the first time disclosed its updated 2009 pro forma financial statements for the combined companies. The table above compares the reported pro forma results for the combined Frontier/VSTO operations in 2009 versus 2008, and it clearly paints a fairly discouraging